

Web Exclusive: A Round-Table Discussion on Regulating Charities

November 14, 2004

By BERNARD STAMLER

Amid so much talk of abuse among public charities and foundations today, many legislative and regulatory bodies are contemplating or instituting new rules governing these groups - covering everything from stricter reporting and auditing requirements to conflicts of interest, board responsibility and excessive compensation.

Is such regulation a good idea? Need? Or counterproductive?

We asked four people involved in the issues to join an online discussion. The participants were Florence L. Green, executive director of the California Association of Nonprofits, a group with more than 1,700 members; Evelyn Brody, a professor at the Chicago-Kent College of Law, who studies nonprofit regulation and governance; Pablo Eisenberg, a senior fellow at the Georgetown Public Policy Institute in Washington; and Diana Aviv, president of Independent Sector, a trade association in Washington representing about 700 nonprofit groups and foundations.

Following are excerpts from their e-mail exchanges:

MS.

GREEN: One of the ironies of all this talk is that there is no evidence beyond the few highly publicized cases that nonprofit malfeasance or mismanagement has increased.

However, it almost doesn't matter, because what we do know is that far too many members of the general public perceive that nonprofits are not managing money as they should.

I know of no research that shows or demonstrates that regulations actually improve management practice. The vast majority of nonprofits is operating legally and ethically and adheres to their mission, not because of regulations but because it is what they want to do. It is what their boards and constituencies expect them to do.

But that doesn't let nonprofits off the hook. Doing nothing is not the answer.

We see a need for increased regulation and implementation of laws already in place that will reduce or eliminate inappropriate conflicts of interest and self-dealing practices with meaningful punishment when abuse occurs.

MS. BRODY: I share the fear that legislatures might react to perceived abuses in the charitable sector by declaring, ``There oughta be a law!'' There already are laws against most of the behavior that has been identified as inappropriate.

The lack of enforcement of those laws can easily be blamed

on the lack of resources that legislatures allocate to nonprofit enforcement.

I don't think, however, that we can let the regulators off this easily. In their role as guardians against consumer fraud, state regulators concentrate on the fund-raising activities of charities. When they do address fiduciary duty, most prosecutions involve, properly, acts of self-dealing. For those few cases involving poor governance - perhaps rising to the level of board abdication - regulators or courts sometimes intone tough-sounding legal standards while actually treating the charity fiduciary leniently in order not to discourage charity service.

So are private or peer regulators the answer? Unfortunately, they can be just as timid, if not more so, than government regulators.

Indeed, the relationship between the private regulator and regulated can become just as complicated as that between government agencies and their regulated industries.

MS. GREEN: With all the lamenting about nonprofit accountability, no government or foundation funder is willing to pay for it. Most nonprofits, particularly small organizations, do not have the resources it takes to do this work.

MS. AVIV: It almost goes without saying that whenever abuse occurs in the charitable sector it should be addressed, though it's worth noting that in this large sector of 1.4 million charities, foundations and public-interest organizations, those that engage in illegal or unacceptable practices comprise a minute percentage of the field.

The question remaining, therefore, is what to do about the legal but unseemly or excessive practices that have come to light. Part of the challenge in answering this question is to define what we mean by excessive and also consider whether the particular practice in question is undesirable in all cases.

While additional regulation may be called for to deal with some of the practices within the sector that are not consonant with the spirit and mission of these organizations, any such action must take into account the diversity of organizations that occupy this important space in society.

Self-regulation works for those willing to comply, either because they believe they ought to or because of peer pressure. It is not likely to work with those C.E.O.'s and boards who willfully ignore standards of good ethical practice.

MR. EISENBERG: Are there sufficient nonprofit abuses, inappropriate expenditures and malpractices to warrant all the attention heaped upon the sector? I believe the answer is clearly yes.

There are, I'm afraid, lots of bad apples - too many to pass off as aberrations uncovered by a probing media. Flo also mentions that there is little evidence beyond a few

highly publicized cases that the number of wrongdoings has not increased. I submit that this is not the case; every day another newspaper comes up with yet one more account of foundation or nonprofit misbehavior.

There is evidence that regulations can improve practices. A major case is the 1969 Tax Reform Act, which helped to clean up a previously unaccountable philanthropic sector. One might say it probably saved philanthropy. Regulations and the threat of enforcement also serve as deterrents to poor nonprofit behavior. Until the Senate Finance Committee came along, few nonprofits expressed much concern about improving public accountability and eliminating abuses. Suddenly, with the threat of possible new legislation and regulations in the air, nonprofits are scurrying around talking about new measures for self-reform, better regulator oversight, improved 990's [the tax form that nonprofits file with the I.R.S.], etc.

Many of the scandals uncovered by the media involve self-dealing practices. That is not surprising, given the huge loophole in the existing self-dealing regulations governing private foundations, which permits trustees and other disqualified persons to receive compensation for services provided to their foundations if they are reasonable, necessary and not excessive. The Internal Revenue Service has not provided any criteria for what is reasonable and necessary. Nor has it been willing to challenge any obvious violators. ``Everything goes'' has thus been the rule for foundations.

Based on a study that my students did a year ago, I would guess that foundations spend over \$300 million a year on such fees, money that could be spent on nonprofits.

We need new regulations to prevent these abuses. I have suggested a yearly limit on payments to trustees for both fees and services of \$8,000. There is no reason why services given by trustees and other disqualified persons could not be provided by outsiders, often at less of a cost and more effectively.

MS. GREEN: I will say that I disagree with Pablo that there is a clear yes to whether there is sufficient nonprofit abuse. We absolutely do not know.

The critical issue is that the laws to prevent most of the abuse are already on the books, but there are just too few resources to enforce them.

Almost any accountant will tell you that an audit does not reveal abuse or fraud. An audit just tells us at a specific moment in time what the financial circumstances of an organization look like. To assume the audit will improve accountability is foolhardy. Most of the groups that made the newspapers have had audits. I believe audits are a good and important practice and should be encouraged, but they should not be mandated, particularly when funds are down and needs for service are up.

MS. BRODY: While the notion of abuses grabs the headlines, I would prefer to think about structural impediments to maximizing the benefits to society from charity operations.

I appreciate that one aspect of the value of our current ``free market'' for charities is the diversity of causes and approaches to those causes, as well as the opportunity that charities provide for participation in developing social capital. At the same time, I worry about the proliferation of new charities - what are the 70,000 new 501(c)3 [tax-exempt] organizations doing that wasn't being done last year?

Every organization requires a minimum amount of time and resources to be operated competently, and often should be governed by a group of independent directors. Where are these directors coming from?

MR. EISENBERG: Let me disagree with Flo. There is a lot of rot in our sector, more than many of us are willing to admit.

Evelyn should be worried about the almost automatic approval by the Internal Revenue Service of 70,000 to 80,000 new 501(c)3's every year. The initial review should be much more stringent; this means adding more staff to do this job well. Many of the totally political nonprofits might have been denied tax exemption had they been subjected to a more thorough examination. And I believe there should be a review of the status of nonprofits every 10 years to make certain they are still fulfilling their mission.

MS. AVIV: On the question of trustees, I do not subscribe to the school that believes that trustee compensation is necessary in order to attract the top leadership of the country to serve on governing boards. I suspect that many leaders and prominent individuals would consider it an honor to serve on a foundation board.

Having said that, the question is whether trustee compensation limits should be set by government or by voluntary guidelines created by various subsectors and whether the law should apply in all circumstances.

There are some trustees of smaller foundations who do the work that staff might do in large foundations. A great deal of time is expected from them, and, to be sure that they are meeting their responsibilities fully, it may be appropriate to pay them for their time. We don't want to arrive at a place where only the wealthiest individuals can afford the time and resources to serve on boards. At the same time, it is unseemly to find very large checks lining the pockets of some board members. Or for wealthy individuals to create foundations so that their relatives and dear friends have a place to work and be well paid.

The question again is how to solve the problem. We all know that the law tends to be a very blunt instrument and could have the effect of creating more problems than it solves.

Copyright © 2004 The New York Times Co. Reprinted with permission.